

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 2004-90-W/S - ORDER NO. 2004-434  
SEPTEMBER 17, 2004

IN RE: Application of Total Environmental Solutions, Inc. (TESI) for Approval of an Adjustment of Rates and Charges for Water and Sewer Services.	)	FINAL ORDER ON APPLICATION FOR INCREASE IN RATES
	)	

**I. INTRODUCTION**

This matter comes before the Public Service Commission of South Carolina (hereinafter the “Commission”) by way of an Application of Total Environmental Solutions, Inc. (hereinafter “TESI” or the “Company”), filed on March 18, 2004, seeking approval of a new schedule of rates and charges for water and sewer service that TESI provides to its customers within its authorized service area in Oconee County, South Carolina. The Application was filed pursuant to S. C. Code Ann. Sections 58-5-210 et. seq. (1976) and (Supp. 2003), and 26 S.C. Ann. Regs. 103-512 (Supp. 2003).

By letter, the Commission’s Executive Director instructed TESI to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by TESI’s Application. The Notice of Filing indicated the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings. In the same letter, the Executive Director also instructed TESI to notify

directly, by U. S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. TESI furnished the Commission with an Affidavit of Publication demonstrating that the Notice of Filing had been duly published and with a letter in which TESI certified that it had complied with the instructions of the Executive Director to mail a copy of the Notice of Filing to all customers affected by the Application. In response to the Notice of Filing, Petitions to Intervene were filed on behalf of the Consumer Advocate for the State of South Carolina (the “Consumer Advocate”), the Foxwood Hills Property Owners Association, Inc. (“Foxwood Hills”), and the South Carolina Department of Health and Environmental Control (“DHEC”).

Pursuant to S. C. Code Ann Section 58-3-95 (Supp. 2003), a panel of three Commissioners were appointed to hear and rule on TESI’s Application. The panel consisted of Chairman Mitchell, presiding, Commissioner Moseley, and Commissioner Clyburn.

On July 26, 2004, a public night hearing was held in Walhalla, South Carolina in the Oconee County Courthouse. All three panel members were present at the night hearing. Also present at the hearing were many customers of TESI, who were heard to express opposition to TESI’s Application.

On August 24, 2004, a public hearing concerning the matters asserted in TESI’s Application was held in the Commission’s hearing room located at Synergy Business Park, 101 Executive Center Drive – Saluda Building, Columbia, South Carolina. During the proceedings, TESI was represented by John F. Beach, Esquire. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. Intervenor Foxwood Hills was

represented by H. Asby Fulmer, III, Esquire. DHEC was represented by Mason A. Summers, Esq. The Commission Staff was represented by F. David Butler, General Counsel.

After a number of additional public witnesses presented statements to the Commission, TESI presented the testimony of Paul Maeder, Gary Shambaugh, and Bill Schoening. The Consumer Advocate presented no witnesses. Foxwood Hills presented the testimony of Bill Lewis and Michael Dodson. DHEC presented the testimony of Raymond F. Peterson. The Commission Staff presented the testimony of Sharon G. Scott and William O. Richardson.

In considering the Application of TESI, the Commission must consider competing interests. The interests of the consumers in receiving quality service and a quality product at a reasonable rate compete with the interests of the provider in having the opportunity to earn a fair rate of return. Public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. These rates must be “just and reasonable,” with no “undue” discrimination. Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 172. *See also, Heater of Seabrook, Inc. v. Public Service Comm’n of S. C.*, 324 S.C. 56, 478 S.E.2d 826, 830 (1996) (“the Public Service Commission must determine a fair and reasonable rate of return....”)

Thus, in considering the Application of TESI, the Commission must give due consideration to TESI’s total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair return. To this end, the Commission will review the operating revenues and operating expenses of TESI and will endeavor to establish

adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair return for TESI, based upon the record before it. Should the Commission's determination show that rates should be increased, the Commission will then design rates that will meet the revenue requirements of TESI, but that are also just and reasonable and free of undue discrimination.

## **II. FINDINGS OF FACT**

1. TESI is a water and sewer utility providing water and sewer service in its assigned service area within South Carolina, and its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S. C. Code Ann. Section 58-5-10 et seq . (1976 & Supp. 2003).

2. The appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002, including known and measurable changes through the date of this hearing.

3. The Commission will use the operating margin as a guide in determining the lawfulness of the Company's rates and in the fixing of just and reasonable rates.

4. By its Application, TESI is seeking an increase in its rates and charges for water and sewer services equal to \$538,490 of additional revenues.

5. The appropriate operating revenues for TESI for the test year, under present rates and after accounting and pro forma adjustments, are \$252,924.

6. The appropriate operating expenses for TESI for the test year, under present rates and after accounting and pro forma adjustments and adjustments for known

and measurable out-of-test year occurrences, are \$425,629 and the appropriate rate base for the test year after accounting and pro forma adjustments is (\$61,980).

7. The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is (68.28)%.

8. Based on the operating margin for the test year after accounting and pro forma adjustments, we find that TESI has demonstrated the need for an increase in rates.

9. When applied to as adjusted test year operations, the rates requested and proposed by TESI result in an operating margin of 28.68%.

10. The Commission finds that an operating margin of 28.68% is unjust and unreasonable as producing excessive revenues. The Commission finds and concludes that an ultimate fair operating margin that the Company should have an opportunity to earn is 20.00%.

11. The level of operating revenues required in order for TESI to have an opportunity to earn a 20.00% operating margin is found to be \$609,624. However, the Commission finds that the per customer increase to obtain the 20.00% operating margin is quite large and constitutes a tremendous percentage increase over present rates. The Commission further finds that in order to lessen the impact of a one-time rate increase, that it is appropriate to phase-in the rate increase.

12. The Commission finds that the rate increase in monthly rates and charges should be phased in in three installments over a two year period as outlined below. The amount of additional revenue needed for the first phase is \$146,162, for the second phase is \$251,431, and for the final phase is \$356,700. Also, we find that an RV rate should be

established for both water and sewer, which shall be set at three-fourths of the residential rate.

13. To achieve a final operating margin of 20.00% following a three part phase-in of rates, the Commission approves an increase in monthly rates as follows: (1) the first part of the phase-in shall be an increase in residential rates for water to \$30.17, and in RV rates to \$22.62; (2) the second part of the phase-in shall be an increase in residential rates for water to \$41.38, and in RV rates to \$31.04; (3) the third part of the phase-in shall be an increase in residential rates for water to \$52.60, and in RV rates to \$39.45. Commercial rates shall also be phased-in in three phases as shown on Appendix A. With regard to sewer rates (1) the first part of the phase-in shall be an increase in residential sewer rates for sewer to \$34.95, and in RV rates to \$26.21; (2) the second part of the phase-in shall be an increase in sewer rates to \$40.95, and in RV rates to \$30.71; (3) the third part of the phase-in shall be an increase in sewer rates to \$46.95, and in RV rates to \$35.21. Commercial rates shall also be phased-in in three phases as shown on Appendix A.

14. The second and third part of the increased rates stated in paragraph 13 shall be contingent upon TESI verifying to the Commission that the system is in compliance with all applicable DHEC regulations forty-five (45) days prior to the new rates implementation.

15. Among other changes in rates, TESI has asked to increase the sewer reconnection fee to \$400.00 and the water reconnection fee to \$250.00. The Company has

also asked the Commission to approve several new nonrecurring and miscellaneous charges. They are:

- |                       |   |
|-----------------------|---|
| a. Plant Impact Fee   | \$400.00  |
| b. Administration Fee | \$ 45.00  |
| c. Service Charge     | \$ 20.00 during business hours<br>\$ 35.00 after business hours |
| d. Theft of Service   | \$500.00  |
| e. Tampering          | \$250.00  |

16. The Commission finds that the proposed rate changes for water reconnection are excessive and not supported by any evidence in the record of this case. As to the sewer reconnection fee, there is nothing in the record to either suggest or support a waiver of the Commission regulations which establish a sewer reconnection fee of \$250. We find that the sewer reconnection fee of \$250 is appropriate. There is nothing in the record to support the other proposed miscellaneous charges. The Commission finds these charges to be excessive and they are, therefore, denied.

### **III. EVIDENCE TO JUSTIFY FINDINGS OF FACT**

In this section, the Commission sets forth the evidence relied upon in making its Findings of Fact as set forth in Section II of this Order.

#### **1. EVIDENCE FOR FINDING OF FACT NO. 1**

The evidence supporting this finding concerning the Company's business and legal status is contained in the Application filed by TESI, in the testimony of TESI witness Maeder, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. By the Application, TESI admits that it is a public utility within the meaning of S. C. Code Ann Section 58-5-10(3) (Supp. 2003) and that it is providing sewer services to 543 customers and water services to 561

customers in Foxwood Hills. This finding of fact is essentially informational, procedural, and jurisdictional in nature, and the matters which it involves are not contested by any party.

## 2. EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 2

The evidence supporting this finding, that the appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002, is contained in the Application filed by TESI and in the testimony and exhibits of the parties' witnesses.

On March 17, 2004, TESI filed its Application requesting approval of rate schedules designed to produce an increase in gross revenues. Application of TESI, Exhibits B and C. The Company utilized a test year ending December 31, 2002.

The test year is established to provide the basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are in effect. Porter v. South Carolina Public Service Commission, 328 S.C. 222, 493 S.E.2d 92 (1997), citing Hamm v. S.C. Pub. Serv. Comm'n, 309 S.C. 282, 422 S.E.2d 110 (1992).

The Commission concludes that the appropriate test year to use in the instant proceeding is the twelve month period ending December 31, 2002. No party contested the use of that test year as proposed by TESI in its Application.

## 3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

In its Application, TESI did not specify or propose a particular rate setting methodology.



“The Public Service Commission has wide latitude to determine an appropriate rate-setting methodology.” Heater of Seabrook v. Public Service Commission of South Carolina, 324 S.C. 56, 64, 478 S.E.2d 826, 830 (1996).

The Staff in its exhibits and testimonies presented information regarding the operating margins for per books test year, test year as adjusted, and after the proposed increase. The Commission Staff also presented various alternative operating margins and associated revenue requirements for those operating margins. The Commission finds that operating margin is the appropriate rate-setting methodology to use in this case.

#### 4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by TESI and in the testimony and exhibits of Staff witness Richardson. The Application of TESI indicates that it is seeking additional revenues of \$540,065 from the proposed rates for its water and sewer operations. Application of TESI, Exhibits B and C. Additionally, Staff witness Richardson testified that under the rates proposed in the Application, TESI would see an increase in revenues of \$538,490. Hearing Exhibit No. 9 (Utilities Department Exhibit No. 2).

We adopt Staff’s calculation of the increase in revenues because the Staff’s calculation appropriately reflects annualized charges for water and sewer service without any additional miscellaneous charges. Staff’s adjustment to annualize the rates recognizes revenues for water and sewer service for a full year under the approved rates. We find that the annualized revenues as calculated by the Staff to be appropriate to use in

establishing rates. Therefore, the Commission finds that TESI is seeking an increase in its revenues of \$538,490.

#### 5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

TESI's Application shows per book test year total operating revenues of \$211,044. Application, Exhibits B and C. Staff began with the per book test year operating revenues of \$211,044, and Staff proposed an adjustment to per book operating revenues to annualize service revenues using year-end customers. Hearing Exhibit No. 7, P. 6 (Audit Exhibit AC). Staff's proposed adjustment results in an increase to per book operating revenues of \$41,880. We find the adjustment proposed by Staff to be reasonable and adopt the Staff's adjustment. See, Evidence and Conclusions for Finding of Fact No. 4, above. Therefore, we find the appropriate operating revenues for the test year after accounting and pro forma adjustments are \$252,924.

#### 6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The parties offered certain adjustments affecting operating expenses for the test year. TESI witness Shambaugh and Staff witness Scott offered testimony and exhibits detailing adjustments proposed by the parties. See Hearing Exhibit No. 7 (Exhibits sponsored by Staff witness Scott) and TESI's Application.

##### **(A) Revenues**

(1) Position of the Company: TESI proposes to reflect revenues based on a bill frequency analysis using present rates and proposes a combined adjustment of \$27,354. However, according to Company witness Shambaugh's rebuttal testimony, a more

detailed Company analysis produces an adjustment of \$49,126. Shambaugh Rebuttal testimony at 3.

(2) Position of Staff: The Utilities Staff proposes to adjust revenues using the number of customers at December 31, 2003 under present rates and proposes a combined adjustment of \$50,701. Hearing Exhibit 7, Audit Exhibit A-1, page 1 of 11.

(3) Decision of the Commission: The Commission finds that the Staff's adjustment should be adopted. The difference between the two adjustments is insignificant; however, we will use the Staff adjustment. We would note that this adjustment and certain other adjustments discussed herein infra, utilize numbers from outside the test year ending December 31, 2002. It should be noted that the South Carolina Supreme Court has authorized the Commission to adopt a historical test year so long as adjustments are made for any known and measurable out of period changes in expenses, revenues, and investments which would materially alter the rate base. The object of test year figures is to reflect typical conditions. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. See Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978); See also the cases cited in Parker v. The South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984). For this adjustment and the adjustments discussed herein infra, that are outside the test year, we hold that these are adjustments for known and measurable out of period changes, so as to attempt to reflect typical conditions as required by the Supreme Court.

**(B) Customer Growth**

(1) Position of the Company: The Company proposes to reflect revenues for customers gained during 2003 and proposes a combined adjustment of \$6,898.

(2) Position of Staff: The Utilities Staff did not make a separate adjustment since it annualized revenues using 2003 year-end customers. Id.

(3) Decision of the Commission: The Commission finds that no customer growth adjustment is needed since revenues are annualized based on 2003 year-end customers.

**(C) Revenues for Unbilled Customers**

(1) Position of the Company: The Company proposes to reflect revenues for customers previously not being billed and, therefore, proposes a combined adjustment of \$14,874.

(2) Position of Staff: Again, the Utilities Department did not make a separate adjustment since it annualized revenues using 2003 customers, which includes these customers.

(3) Decision of the Commission: No adjustment is needed because the customers in question were taken into consideration by annualizing revenues using 2003 customers.

**(D) Revenues for New Taps**

(1) Position of the Company: The Company proposes to reflect additional revenues for new taps and, therefore, suggests a combined water and sewer adjustment of \$2,200.

(2) Position of Staff: For ratemaking purposes, fees for new taps are considered contributions in aid of construction and are a deduction from the Company's rate base. A

combined adjustment of (\$5,600) is proposed. Hearing Exhibit No. 7, Audit Exhibit A-1, Page 2 of 11.

(3) Decision of the Commission: We agree with the Staff and adopt its adjustment. The Staff has proposed that the December 31, 2002 per book level of customer tap connections fees (\$5,600) be treated as contributed property. The Staff considers tap fees of \$19,300 as Contributions in Aid of Construction based on the NARUC Uniform System of Accounts, Account Number 271. The Staff states, and we agree, that the cost of providing a tap should be capitalized, based on the NARUC Uniform System of Accounts in Account # 333 for water and Account #363 for sewer for Services to Customers. Tap fees are considered as Contributions in Aid of Construction and are subtracted from the Company's rate base since the tap fees are cost free capital to a utility. Further, Staff's treatment of tap fees as Contributions in Aid of Construction does not prevent the Company from collecting the Commission-approved tap fee amount. Testimony of Staff witness Scott, Tr. Vol. 3, at 8-9.

**(E) DHEC Revenue and Expenses**

(1) Position of the Company: The Company agrees with the Staff.

(2) Position of Staff: The Staff proposes to remove DHEC's pass-through revenues and expenses from the per book numbers. The Staff's adjustment is (\$3,221) to miscellaneous income and (\$2,989) to General and Administrative expenses. These fees are not regulated by the Commission.

(3) Decision of the Commission: The Staff's adjustment is adopted, since we agree that these fees are not regulated by the Commission.

**(F) Direct Wages and Benefits for South Carolina Employees**

(1) Position of the Company: The Company used an anticipated hourly wage and allocated a portion of the expenses to the Lockhart operation and proposes a combined adjustment of \$65,444.

(2) Position of Staff: The Staff used hourly rates as of May 2004 and wages and benefits information as of April 2004 to compute the expenses for employees' health, dental, and retirement benefits, and the Staff proposed a combined adjustment of \$46,401.

(3) Decision of the Commission: The difference between the two positions results primarily from the loss of one employee, a field technician, that the Company did not replace. Staff did not include the field technician in its adjustment since it was not a known and measurable change. The Company had not replaced the technician at the time of the hearing. We agree with the Staff and adopt its adjustment. Because no field technician is presently employed by the Company, there cannot be a known and measurable change.

**(G) Increase in Purchased Water**

(1) Position of the Company: The Company proposes to adjust expenses to reflect an increase in purchased water costs in the amount of \$2,321.

(2) Position of Staff: Staff at first opposed the adjustment, but in surrebuttal testimony, concurred in it.

(3) Decision of the Commission: The adjustment is appropriate and is granted.

**(H) Increase in Purchased Power Costs for Booster Stations**

(1) Position of the Company: The Company originally proposed to reflect an increase in purchased power costs for booster stations, which would have amounted to a combined adjustment of \$20,000.

(2) Position of the Staff: During the audit, the Company informed Staff that this adjustment should be eliminated, since the booster stations were not purchased. Staff, accordingly, did not make this adjustment.

(3) Decision of the Commission: The adjustment is eliminated.

**(I) Contract Operation Expenses**

(1) Position of the Company and Staff: At first, both Company and Staff proposed to remove contract operation expenses for the daily operation of the wastewater treatment plant, lab work samples, transporting of monthly reports to DHEC, and collection of water samples along with other maintenance work, under a belief that the Company's employees began to perform this work during 2003. However, after the audit, it was revealed that contract operations were still ongoing. The Company provided invoices accordingly for the monthly charges of \$3,000, and Staff verified the amounts to the 2003 general ledger. Staff agrees with the inclusion of \$36,000 for contract services.

(2) Decision of the Commission: The Commission adopts the adjustment.

**(J) Insurance Expenses**

(1) Position of the Company: The Company proposes an adjustment for the increase in insurance premiums for General Liability, Worker's Compensation, Vehicle and Pollution Liability/Environmental Impairment. The Company's adjustment is based

on estimated premiums allocated to its South Carolina operations. The Company's proposed combined adjustment is \$22,831.

(2) Position of the Staff: The Staff proposes an adjustment for the increase in insurance premiums, based on actual premiums for the period December 23, 2003 through December 23, 2004, allocated to South Carolina. The Staff's proposed combined adjustment is \$14,165.

(3) Decision of the Commission: The Company and Staff used basically the same methodology for the adjustment. The differences are due to the following: the Staff used the actual invoice amounts for the premiums for the period covering December 2003 to December 2004 and the Company used estimated amounts; the Staff allocated a portion of the general liability insurance to the corporate office; the Staff allocated a portion of the general liability insurance adjustment to the unregulated Lockhart operation based on customers, and the Company only allocated 1% to Lockhart; the Company also allocated 1% of the remaining insurance expenses to Lockhart, and the Staff did not allocate Workers' Compensation to Lockhart. See Surrebuttal testimony of Staff witness Sharon Scott at Tr. Vol. 3 at 35. After due consideration, we adopt Staff's adjustment. Using actual premium amounts is preferable to using estimated amounts. Also, it seems reasonable to adopt Staff's approach on its allocations of insurance expenses to Lockhart.

**(K) Allocation of Affiliate Services**

(1) Position of the Company: The Company proposes to include an allocation of affiliated services for the corporate office located in Baton Rouge, Louisiana and from the parent company, South Louisiana Electric Cooperative Association ("SLECA"). This



adjustment consists of several components which include the corporate office building expenses, computer services, salaries and wages, etc. The Company includes a coverage charge of 5% and 20% above expenses and allocates expenses to Lockhart. The Company proposes combined adjustments to general and administrative expenses of \$52,565, to depreciation and amortization expenses of \$2,737, and to taxes other than income of \$1,948.

(2) Position of the Staff: Staff used the same methodology to compute the Affiliated Services Charge as the Company, with the exception of the Debt Service Costs and Facilities Costs. Staff proposes combined adjustments of \$34,044 to general and administrative expenses, \$0 to depreciation, and \$1,369 to taxes other than income. The differences in amounts are mainly due to the elimination of the 700 Lockhart customers from the computation of Allocation Factor No. 1 and Allocation Factor No. 2. Staff states that the Lockhart system is a contract customer with little to no work done from the corporate office for the Lockhart system. Only one bill is sent to the Town of Lockhart. Additional differences between Staff and Company adjustments are the disallowance of depreciation expense and elimination of the 5% and 20% coverage factors.

(3) Decision of the Commission: We adopt Staff's adjustments. We believe that, under the circumstances, elimination of the Lockhart customers from the calculations is appropriate, since little or no work is done from the corporate office that benefits the Lockhart system. We agree that no depreciation expense should be allowed under the circumstances, due to the Company's resultant negative rate base as calculated by the Staff. Further, the 5% and 20% coverage factors proposed by the Company are only for

contingencies and are, therefore, not known and measurable. These must be eliminated. The Staff's adjustments are the most appropriate, given the circumstances of this case. See Surrebuttal Testimony of Staff witness Sharon Scott at Tr. Vol. 3 at 35-38. We are mindful of the Company's testimony in this area, but we do not find it persuasive. We disagree with the Company that the Staff testimony is "simplistic," and hold that the Staff's allocation of expenses to TESI's South Carolina facilities is the appropriate methodology to use, in that it assigns affiliate costs properly, using a logical basis, i.e. number of customers.

**(L) Rate Case Expenses**

(1) Position of the Company: The Company proposes a rate case expense calculation including estimated expenses of \$120,000 for water and \$120,000 for sewer, less per book rate case expenses, amortized over a 3 year period. Company's combined proposed adjustment is \$61,190.

(2) Position of the Staff: The Staff proposes a rate case expense adjustment based on actual expenses to May 2004. The proposed Staff combined adjustment is \$13,995. The last rate case for TESI's predecessor company was filed in 1993, which is eleven years ago. However, the Staff proposes to amortize the rate case expense over a more reasonable time period of 5 years. The Staff stated in surrebuttal testimony that it did not object to updating rate case expenses for this proceeding for known and measurable expenses supported by invoices; however, no such additional invoices were proffered by the Company.

(3) Decision of the Commission: We adopt Staff's adjustment, which is based on actual expenses to May 2004. We believe that a 5 year amortization period for recovery of these expenses is more reasonable than use of the actual time since TESI's predecessor's rate case. Since the Company did not proffer any additional invoices for rate case expenses, we have no mechanism to update our consideration of these expenses.

**(M) Depreciation Expense**

(1) Position of the Company: The Company proposes to include depreciation expense for the original plant in service based on a cost study and for 2003 plant additions. The proposed Company combined adjustment is \$101,701.

(2) Position of the Staff: The Staff used the purchase price and plant additions since the Company was purchased, reduced this amount by tap fees and plant enhancement fees collected by the Company and added a cash working capital allowance to rate base. As a result, the Staff takes the position that the Company has a negative rate base and, therefore, no depreciation expense is allowable. This is all laid out in detail in Hearing Exhibit 8, the exhibit to Staff witness Sharon Scott's surrebuttal testimony. Staff made a combined adjustment to remove all depreciation expense from the books for the test year of (\$5,821). Staff did propose an alternative adjustment, using the Company's depreciation study.

(3) Decision of the Commission: We hold that Staff's original adjustment is appropriate and adopt same. We reject the alternative method. With regard to the purchase price, based on the NARUC Uniform System of Accounts, the Staff has proposed to only allow the Company the allocated purchase price for South Carolina,

which we think is correct. The allocated amount of \$82,640 ( $2.39536\% \times$  the total TESI purchase price of \$3,450,000) was based on the number of South Carolina Mountain Bay customers at December 31, 2002 of 1,021 and total TESI customers of 42,624. See Surrebuttal Testimony of Staff witness Sharon Scott at Tr. Vol. 3 at 39. With regard to contributed property, the Staff verified enhancement fees per book for 2002 of \$175,728. Staff discovered after its audit that a bad debt amount of \$147,735 was applicable to plant enhancement fees. Id. at 40. Staff took the position that this amount of bad debt expense was excessive and that the Company should take some type of action to make these collections. Accordingly, Staff did not propose to reduce the billed enhancement fees by the bad debt amount. Id. We agree with the Staff. We are not convinced, after hearing the Company's testimony, that the Company has exhausted all possible attempts to collect these funds. Accordingly, in order to encourage further collection efforts by the Company, we hold that the amount of billed enhancement fees shall not be reduced by the bad debt amount at this time. If, in some future proceeding, the Company can convince us that it has exhausted all possible avenues to collect these amounts, we may take a different view. However, at this time, the amount of billed enhancement fees shall not be reduced by bad debts.

Further, we hold that the Company's rate base shall be reduced by plant enhancement fees for 2002 and 2003 in the amount of \$351,756, as well as by the amount of cumulative tap fees in the amount of \$19,300. These amounts are contributions in aid of construction as per the NARUC System of Accounts. We do not understand the Company's belief that such a subtraction would be retroactive ratemaking by this

Commission, considering the NARUC System of Accounts. The Company has not presented any evidence to support this claim.

We are making a conscious decision to include the collection of enhancement fees for both 2002 and 2003 for subtraction from rate base. We are mindful that TESI itself collected the enhancement fees in 2002, and that Total Environmental Solutions Management Company of Louisiana, Inc. (TESI Management) collected the fees in 2003, pursuant to an Assignment of Right to Receive Lot Enhancement Fees. (Hearing Exhibit 3). Even though the latter company is nominally a separate company from TESI, we are convinced that the two companies have a sufficiently close relationship so as to attribute the enhancement fees collected by TESI Management to TESI the utility. According to the testimony of Company witness Paul Maeder, both companies have the same board of directors. Further, at the time of the Assignment, both companies had the same Chief Executive Officer. In addition, Maeder stated that the sole purpose of the establishment of TESI Management was to collect enhancement fees from customers of TESI the utility. With these facts before us, we have no trouble attributing the enhancement fees collected by TESI Management to TESI the utility.

Further, we reject the Staff's alternate proposal, based on the Company's Depreciation Cost Study. The Company's adjustment to depreciation expense amounted to \$38,308 for water, \$63,393 for sewer, and \$101,701 for combined operations. Staff calculated that the Company would have a total rate base of \$1,609,342 based on the depreciation study conducted by the utility for this proceeding. However, as Staff noted, it did not use the study because TESI did not pay \$1,609,342 for the utility. See

Surrebuttal testimony of Staff witness Scott at Tr. Vol. 3 at 39. TESI purchased Mountain Bay and a number of other water and wastewater companies from a bankruptcy proceeding. TESI paid a total price of \$3,450,000 to acquire the total systems from six (6) states. Staff's adjustment allocated the purchase price to Mountain Bay based on the number of customers at December 31, 2002. The total number of customers in all systems purchased was 42,624. Mountain Bay's customer base was 1,021. Therefore, the Staff allocated 2.39536% or \$82,640 of the purchase price to Mountain Bay. TESI made plant additions for 2001 and 2002 of \$80,361 and plant additions for 2003 of \$94,396 at Mountain Bay after they purchased the utility. The total purchase price plus plant additions resulted in Gross Plant in Service of \$257,397. Needless to say, subtraction of contributions in aid of construction, and the addition of a cash working capital allowance, resulted in a negative rate base of (\$61,980). See Surrebuttal Testimony of Staff witness Sharon Scott at Tr. Vol. 3 at 29-31. From these calculations and this result, it can clearly be seen that it would be incorrect and improper to attribute a rate base to the Company of \$1,609,342. This figure has no relation to what the Company actually paid for the assets. Accordingly, we reject the Staff's alternative proposal on that basis.

**(N) Nonallowable Penalty**

(1) Position of Company and Staff: Both the Company and the Staff propose to remove a nonallowable penalty of \$4,900 paid to DHEC. The payment was for a civil penalty in reference to a specific Consent Order.

(2) Decision of the Commission: We approve the adjustment.

**(O) Nonallowables**

(1) Position of the Company: No position.

(2) Position of the Staff: Staff proposes to remove expenses which the Staff considers to be nonallowable for ratemaking purposes. These expenses include credit card penalties of \$121, legal fees miscoded to the utility of \$180, and a late payment fee for purchased water of \$787.

(3) Decision of the Commission: We approve the Staff adjustments.

**(P) Property Taxes**

(1) Position of the Company and Staff: Both the Company and the Staff propose to reclassify property taxes that were incorrectly booked to the water system. The adjustment corrects the allocation between water and sewer.

(2) Decision of the Commission: We approve the adjustment.

**(Q) Gross Receipts Tax on Present Revenues**

(1) Position of the Company: The Company proposed an assessment rate of .01324 for water operations and taxable revenues of \$113,642. The Company computed an amount of \$1,739<sup>1</sup> less the per book gross receipts of \$1,613 for an adjustment of \$126. The Company used a factor of .00696 for sewer operations and taxable revenues of \$148,728. The Company computed an amount of \$1,270<sup>2</sup> less the per book amount of \$1,065 for an adjustment of \$205. The combined Company adjustment amounted to total taxes of \$3,009 less the per book amount of \$2,678 for an adjustment of \$331. In rebuttal testimony, the Company stated that it did not disagree with the utilization of the current

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<sup>1</sup> This number is apparently a computational error.  $\$113,642 \times .01324 = \$1,505$ .

<sup>2</sup> This number is apparently a computational error.  $\$148,728 \times .00696 = \$1,035$ .

gross receipts factors but that the final adjustment for an annual revenue requirement must be based upon Commission approved pro forma revenues. See Rebuttal testimony of Company witness Gary Shambaugh at 14.

(2) Position of the Staff: The Staff used the most recent PSC assessment rate of .007110428 and its present revenues for water of \$108,267 for a computed amount of \$770 less the per book amount of \$1,613 resulting in an adjustment of (\$843). For sewer operations, Staff used present revenues of \$144,657 and the gross receipts factor of .007110428 for a computed amount of \$1,029 less the per book amount of \$1,065 for an adjustment of (\$36). The combined adjustment totaled \$1,799 less the per book amount of \$2,678 for an adjustment of (\$879).

(3) Decision of the Commission: We adopt Staff's adjustments, which are based on the current gross receipts factor and appropriate pro forma revenues.

**(R) Interest Expense**

(1) Position of the Company: The Company proposes to include Interest Expense as an above-the-line operating expense.

(2) Position of the Staff: The Staff does not consider interest expense as an operating expense, but includes it, if applicable, when computing the Operating Margin. The Staff states that the Company has a negative rate base and therefore no interest expense should be allowed.

(3) Decision of the Commission: We agree with the Staff and disallow any interest expense in this case. No interest expense is available when the Company has a negative rate base. This is true in the present case.



**(S) Adjustment of Revenues for the Proposed Increase**

(1) Position of the Company: The Company's proposed revenue adjustment amounted to \$319,508 for water, \$220,557 for sewer and \$540,065 for combined operations. In rebuttal testimony, the Company stated that, although it disagreed with the Staff's methodology, it really did not disagree with Staff's figure in this case, i.e. \$538,490.

(2) Position of the Staff: The Staff's proposed revenue adjustment amounted to \$318,662 for water and \$219,828 for sewer, for a combined adjustment of \$538,490.

(3) Decision of the Commission: We adopt Staff's position, which has been agreed upon by the Company as to amount.

**(T) Gross Receipts Tax on Revenues After the Proposed Increase**

(1) Position of the Company: The Company used an assessment rate of .01324 for water operations and taxable revenues of \$433,150. The Company computed an amount of \$5,970<sup>3</sup> less the as adjusted amount of \$1,739 for an adjustment of \$4,231. The Company used a factor of .00696 for sewer operations and its taxable revenues of \$369,285. The Company computed the amount of \$2,805<sup>4</sup> less the as adjusted amount of \$1,270 for an adjustment of \$1,535. In its rebuttal testimony, the Company stated again that it did not disagree with the utilization of the current gross receipts factors, but that the final adjustment for an annual revenue requirement must be based on Commission approved pro forma revenues. Id. at 15.

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<sup>3</sup> This number is apparently a computational error.  $433,150 \times .01324 = \$5,735$ .

<sup>4</sup> This number is apparently a computational error.  $369,285 \times .00696 = \$2,570$ .

(2) Position of the Staff: The Staff used the most recent PSC assessment rate of .007110428 and its after the proposed revenue amount for water of \$426,929 for a computed amount of \$3,036 less the as adjusted amount of \$770, resulting in an adjustment of \$2,266. For sewer operations, Staff used the after the proposed increase revenue of \$364,485 and the gross receipts factor of .007110428 for a computed amount of \$2,592 less the as adjusted amount of \$1,029 for an adjustment of \$1,563. The combined adjustment amounted to \$3,829.

(3) Decision of the Commission: We adopt Staff's adjustments, which are based on the current gross receipts factor and appropriate pro forma revenues.

**(U) Adjustment of Income Taxes for Effect of the Proposed Increase**

(1) Position of the Company: The Company used its water taxable income and a state tax rate of 5.0% and a federal tax rate of 34%, resulting in an adjustment after expenses of \$4,406 for state taxes and \$28,460 for federal income taxes. The Company used its sewer taxable income and a state tax rate of 5.0% and a federal tax rate of 34%, resulting in an adjustment after expenses of \$3,756 for state taxes and \$24,264 for federal income taxes. The combined adjustment amounted to \$32,866 for water, \$28,020 for sewer, and total taxes of \$60,886. The Company disagrees with the Staff's income tax calculations, since they do not reduce the claim for interest expense and the taxes are based on "excessive" margins.

(2) Position of the Staff: The Staff used the after the proposed increase revenues for water of \$424,620, sewer of \$363,813 and miscellaneous income of \$2,981, less operating expenses for taxable income. Staff used a 5% state tax rate and 34% federal tax

rate resulting in an adjustment of \$135,010 for combined operations, based on Staff's surrebuttal testimony. Staff also states that, since the Company has a negative rate base, that no interest expense should be utilized in calculating income taxes.

(3) Decision of the Commission: We adopt the Staff's adjustments. We agree with the Staff that no interest expense should be used in calculating income taxes, since the Company has a negative rate base. We disagree that Staff has calculated excessive margins in this case. The margins occur only as the result of calculating the income to revenue ratio, based on Staff's adjustments. Including the additional purchased water costs of \$2,321 and the \$36,000 for contract operation expenses, the resultant margins are 27.55% for water, 29.99% for sewer, and 28.68% for combined operations.

#### 7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is (68.28)%. The calculation for the operating margin using the test year as adjusted operating revenues of \$252,924 as approved herein and test year as adjusted operating expenses of \$425,629 as approved herein was provided by Staff witness Scott. Adjusted test year operations result in a "Net Loss for Return" of (\$172,705). Using the adjusted Net Loss for Return minus Interest Expense if applicable divided by Operating Revenues, Staff calculated a negative operating margin of (68.28)%.

The following table indicates (1) the Company's gross revenues for the test year after adjustments approved herein, under the presently approved rate schedule; (2) the Company's operating expenses for the test year after accounting and pro forma

adjustments and adjustments for known and measurable out-of test year occurrences approved herein; and (3) the operating margin under the presently approved schedules for the test year:

**TABLE A**

	<u>Before increase</u>
Operating Revenues	\$ 252,924
Operating Expenses	<u>425,629</u>
Net Operating Income/Loss	(172,705)
Add: Customer Growth	<u>0</u>
NET INCOME/(LOSS) FOR RETURN	<u>(172,705)</u>
Operating Margin	<u>(68.28)%</u>

#### 8. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 8

Based upon the Finding of Fact 7, we find that TESI has demonstrated a need for rate relief in the form of a rate increase. Adjusted test year operations reveal an operating margin of (68.28)%. Clearly, expenses of operating the system outweigh the revenues of the system.

#### 9. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 9

The rates requested and proposed by TESI produce an operating margin of 28.68% when applied to adjusted test year operations. Information concerning the effect of the proposed rates when applied to as adjusted test year operations of TESI is found in the Staff's exhibits introduced during the hearing. The rates proposed by TESI, which would produce additional revenues of \$538,490 result in an operating margin of 28.68%.

#### 10. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 10

The Commission finds that an operating margin of 28.68% is unjust and unreasonable as such an operating margin produces excessive revenues for the Company. The Commission concludes that a fair operating margin for TESI operations is 20.00%.

TESI has opined that it is seeking the requested increase in rates so that TESI may continue to provide water and sewer service to its customers. According to DHEC witness Peterson, DHEC has ordered TESI to upgrade and repair various components of the Company's water and wastewater systems. TESI asserts that in order to continue to serve its customers, the Company requires a significant increase in rates. The Commission recognizes that TESI faces increased costs in continuing to serve its customers and that TESI requires increased revenues just to meet day-to-day operations, without considering the costs associated with any necessary capital improvements required on the system.

While the Commission recognizes a need for increased rates and increased revenues by TESI, the Commission is not without sympathy for the customers. The Commission recognizes that the customers are being requested to pay a sizeable rate for water and sewer service. However, the documentation provided in this case, along with the standards of ratemaking, substantiate the need for a rate increase. The utility is operating in the negative. The Commission must allow for the utility to be viable in order to provide the services to the public.

The Commission recognizes that it must consider the value of the services provided as well as recognize that there is a limit to what the public can bear. The Commission must strike a balance between the revenue needs of the utility and the value of the service to the public. TESI has demonstrated a need for the rate increase. Further, TESI has presented evidence that it will be seeking loans in order to finance the capital projects needed to meet DHEC's requirements. Thus, the Commission must consider that TESI will need to show financial viability and an ability to repay debt in order to obtain necessary financing for the capital projects. However, while keeping in mind the financial status and viability of TESI, the Commission does not ignore the impact of rate increases on the public. In light of these factors and based upon the record in the instant proceeding, the Commission concludes that a reasonable and fair operating margin which TESI should ultimately have an opportunity to earn is 20.00%.

#### 11. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 11

In order to have the opportunity to earn a 20.00% operating margin, TESI will require operating revenues of \$609,624. Table B which follows reflects the phase-in of the 20.00% operating margin and the requisite revenues to allow TESI the opportunity to earn a 20.00% operating margin by the third phase of the rate increase:

**TABLE B**

	<u>After 1<sup>st</sup> Phase of Increase</u>
Operating Revenues	\$ 399,086
Operating Expenses	<u>426,668</u>
Net Operating Income/Loss	\$ (27,582)
Add: Customer Growth	<u>0</u>
NET INCOME/(LOSS) FOR RETURN	<u>\$ (27,582)</u>
Operating Margin	<u>(6.91)%</u>
	<u>After 2nd Phase of Increase</u>
Operating Revenues	\$ 504,355
Operating Expenses	<u>444,537</u>
Net Operating Income/Loss	\$ 59,818
Add: Customer Growth	<u>0</u>
NET INCOME/(LOSS) FOR RETURN	<u>\$ 59,818</u>
Operating Margin	<u>11.86%</u>
	<u>After 3rd Phase of Increase</u>
Operating Revenues	\$ 609,624
Operating Expenses	<u>487,718</u>
Net Operating Income/Loss	\$ 121,906
Add: Customer Growth	<u>0</u>
NET INCOME/(LOSS) FOR RETURN	<u>\$ 121,906</u>
Operating Margin	<u>20.00%</u>

**12. EVIDENCE FOR FINDINGS OF FACT NOS. 12 AND 13**

While keeping in mind the financial viability of the utility, the Commission must consider a method to minimize the effects of the rate increase on the public. A method that may be used to accomplish this goal is to phase in the rate increase over a period of

time. In this particular case, the new rates will be phased in over two years as described above.

A phase in of rates is not a new concept in South Carolina. A phase-in of rates was involved in the case of *Hamm v. South Carolina Public Service Commission*, 294 S.C. 320, 364 S.E. 2d 455 (1988), when South Carolina Electric & Gas Company brought the V.C. Summer Nuclear Station into rate base. While TESI's rates are being set using operating margin methodology rather than rate of return methodology, the large one-time rate increase would be the same for the customers regardless of the methodology used to set the rates. Therefore, the Commission finds that the public interest requires a phase-in of this rate increase in order to lessen the impact of the rate increase on the customers.

With regard to the RV rates for water and sewer, we would note that we previously granted such a rate for sewer in Docket No. 2000-207-W/S, Order No. 2001-887 and Docket No. 2000-210-W/S, Order No. 2004-254. With the TESI system, we believe that the rate is appropriate for water as well.

#### 14. EVIDENCE FOR FINDING OF FACT NO. 14

The Commission finds that in Order to ensure that the customers of the Company are receiving adequate service in exchange for the increased rates approved herein by the Commission, the Company shall provide to the Commission Staff by no later than August 2, 2005 documentary evidence that the Company is in compliance with all applicable DHEC rules and regulations regarding the operation of the Company's water and wastewater systems prior to implementing the second increase in rates approved in this Order. In the event that such verification is not possible, the Company shall provide



documentation to the Commission from DHEC that DHEC is satisfied with the Company's progress in bringing the systems into compliance. Further, the Company shall provide documentary evidence to the Commission that the systems are in strict compliance with all DHEC rules regulations by no later than August 2, 2006 prior to implementing the third phase of rate increases approved in this Order.

#### 15. EVIDENCE FOR FINDING OF FACT NOS.15 and 16

The Company has asked for an increase in sewer reconnection fees to \$400.00 and water reconnection fees to \$250.00. The Commission's Rules and Regulations governing service supplied by sewerage utilities have set the reconnection charge at \$250. See 26 S.C. Code Regs. 103-532.4 and Direct Testimony of Staff witness William O. Richardson at Tr. Vol. 3 at 90. Further, Mr. Richardson notes that the Company has provided no cost justification for the plant impact fee, administration charge, service charge, theft of service charge, and tampering charge in either the Company's application or its direct testimony. Nor has the Company provided any cost justification for the proposed increase in the reconnection fee for water. Id. We agree and hold that the request for approval of these rate changes and establishment of the new rates be denied, except as to the \$250.00 sewerage reconnection fee as established by Regulation.

#### IV. CONCLUSIONS OF LAW

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. Operating margin is the appropriate guide for the Commission to use in determining the lawfulness of the rates of TESI and in fixing just and reasonable rates for TESI to charge its customers in South Carolina.

2. A fair operating margin for the water and sewer operations of TESI in South Carolina is 20.00%.

3. For the test year of December 31, 2002, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$252,924.

4. Using the operating margin of 20.00% found to be fair and reasonable in this Order, the total revenue requirements for TESI are \$609,624.

5. In order for TESI to have an opportunity to earn the operating margins reasonable and approved in this Order and to meet the revenue requirements, TESI must be allowed additional revenues of \$356,700. Because of the amount of the rate increase in this case and other considerations as stated above, the additional revenue shall be phased-in through three phases. The first phase, to be implemented on the date of this Order, will allow total combined operating revenues of \$399,086. The second phase, to be implemented a year after the date of this Order and upon the conditions stated in this Order, will allow total combined revenues of \$504,355. The third phase, to be implemented two years after the date of this Order and upon the conditions stated in this Order, will allow combined operating revenues of \$609,624, as approved by this Commission.

6. The rates approved in this Order are designed to be just and reasonable and without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate operating margin for TESI on its South Carolina operations is 20.00%, to be achieved after all three phases occur.

IT IS THEREFORE ORDERED THAT:

1. TESI is granted an increase in rates and charges as provided herein for its water and sewer operations in South Carolina.

2. The schedule of rates and charges for the first phase of the increase is hereby approved for service rendered on or after the date of this Order. Appendix A, attached hereto, contains the increased rates approved in this Order. The rates and charges for the second phase contained in Appendix A are effective one year from the date of this Order. The rates and charges for the third phase are effective two years from the date of this Order. These increased rates and charges for the second and third phases are contingent upon the Company providing evidence of its compliance with DHEC regulations as provided in Paragraph 14 of the Commissions Findings of Fact. The second and third phases may not be charged to the customers until the Commission issues an appropriate order or directive approving implementation of each phase. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2003).

3. Should the schedules for the first phase approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. TESI shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Water and Sewer Utilities, as adopted by this Commission.

5. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

/s/  
Randy Mitchell, Chairman

ATTEST:

/s/  
O'Neal Hamilton, Vice-Chairman

(SEAL)